

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE ADJUSTMENT OF RATES OF)	
OKOLONA SEWER CONSTRUCTION)	
DISTRICT OF JEFFERSON COUNTY,)	CASE NO. 8751
KENTUCKY)	

O R D E R

On December 29, 1982, Okolona Sewer Construction District ("Okolona") filed an application with this Commission requesting authority to increase its revenues by approximately \$281,914 annually, an increase of 69 percent. Based on the determination herein the revenues of Okolona will increase by \$94,175 annually, an increase of 20 percent.

Public hearings were held in this matter on April 21, 1983, and on May 16, 1983, in the Commission's offices in Frankfort, Kentucky. The Consumer Protection Division of the Attorney General's Office, Woodcrest Apartments, ("Woodcrest"), Preston-Markwell Corporation, d/b/a Markwell Apartments, ("PMC") and River City Properties intervened in this case. Woodcrest and PMC presented testimony of a Certified Public Accountant in support of their opposition to the proposed rate increase at the hearing on May 16, 1983.

COMMENTARY

Okolona is a non-profit sewage treatment system organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 4,964 customers in Jefferson County.

TEST PERIOD

Okolona proposed and the Commission has accepted the 12-month period ending September 30, 1982, as the test period for determining the reasonableness of the rates approved herein. In utilizing the historical test period, the Commission has given full consideration to known and measurable adjustments found reasonable.

REVENUES AND EXPENSES

Okolona proposed several adjustments to revenues and expenses as reflected in Exhibit 5 of the application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Contract Revenue

Okolona proposed an adjustment of \$3,161 to reduce revenue derived from providing maintenance services to other sewer utilities surrounding Okolona. The revenue was for maintenance provided in connection with "emergency sewer problems" incurred by the entities served. In support of this adjustment Okolona contended that this revenue should be excluded for rate-making purposes because it was derived due to operational problems which are not expected to recur. No adjustments were proposed by Okolona to eliminate test year expenses associated with providing

these services. However, Okolona provided information which reflected that expenses totaling \$336 were included in the test period associated with providing these services.^{1/} The analysis of expenses did not include the cost of labor incurred in providing these maintenance services. Exhibit No. 2 of Okolona's response dated March 1, 1983, reflects that most of these emergency sewer problems relate to stopped up sewer lines. Mr. Eugene Nicholas, Manager of Okolona, testified at the hearing on May 16, 1983, that these problems have occurred in the past and are expected to occur in the future.

The Commission is of the opinion that Okolona has failed to present sufficient evidence to support the contention that these problems are non-recurring in nature. In addition, in order to allow a reduction in revenue associated with a non-recurring item all applicable expenses must be identified and excluded as well. It would be unreasonable to conclude that Okolona did not incur costs in excess of \$366 in providing services which generated the \$3,161 in revenue. Therefore, the Commission has determined that a reduction in revenue to exclude income from maintenance services is not justified.

Transfer of Assessments to Cover Administrative Charges

Under the provisions of its assessment bond resolution Okolona transfers a specified amount of revenue from the assessment funds annually to the operation and maintenance fund as compensation for administrative costs incurred in administering the assessment bonds. Okolona proposed an adjustment to reduce the amount transferred during the test year by \$4,695 based on a

reduction in administrative costs due to retirement of a portion of the assessment bonds. An analysis of the administrative costs was included in Exhibit No. 3 of Okolona's response dated March 1, 1983, which reflected administrative charges for the various assessment bond funds. At the hearing on April 21, 1983, Mr. Blitzko, CPA, testified that pro forma administrative costs should also be included for the Old Minor Lane assessment bonds and the Blue Lick Road assessment bonds. Therefore, the Commission has determined that an additional \$1,594 should be added to the pro forma amount proposed by Okolona. This change results in a total of \$29,944 for transfer of assessments to cover administrative charges.

Miscellaneous Fees

Okolona proposed an adjustment to delete the total amount reported in operating income during the test period for miscellaneous fees. The amount reported was \$16,427, of which \$15,724 was attributable to fees associated with new construction within Okolona's service area. Okolona contended that no revenue will be generated from miscellaneous fees subsequent to the test period because no new construction is anticipated. The fees for new construction are based on provisions of Okolona's former tariff which was cancelled in June of 1982. The Commission has determined that these fees are not cost-justified and should not be classified as operating revenue. These fees apparently are tap-on fees and as such should properly be recorded as contributions in aid of construction. Therefore, the Commission has determined that the charging of these fees was improper and a

refund should be made to the parties involved. Additionally, it should be noted that Commission policy does not allow tap-on fees for sewer utilities and Okolona's revised tariff filed in June of 1982 does not contain a provision for such fees.

An adjustment has been made to decrease miscellaneous fees by \$15,724 to delete the fees which are not cost justified.

Salaries and Wages

Okolona proposed an adjustment to increase salary and wage expense by \$19,603 based on an 11.5 percent wage increase to permanent employees on December 1, 1982, and a proposal to hire additional personnel. Okolona had six full-time employees at the end of the test period and part-time personnel were used at various times during the test period. The last wage increase prior to the increase granted in December of 1982 was in December of 1981 and that increase was 15 percent. In addition to wages, Okolona employees are eligible for health insurance coverage, and dental coverage. The costs for these programs are paid by Okolona.

The Commission is of the opinion that the wage increase granted is excessive and unreasonable and should not be allowed in total for rate-making purposes. The management of Okolona believed that the employees were entitled to this increase and therefore it was granted. However, the Commission is of the opinion that inadequate consideration was given to Okolona's financial condition in evaluating the increase. Furthermore, no evidence has been presented to support the necessity of an 11.5 percent increase. Factors such as the financial condition of the

utility, prevailing economic conditions, the type of work performed, the level of compensation necessary to retain competent employees, and fringe benefits should be considered when wage increases are being evaluated. When such factors are not adequately considered in the case of a regulated utility in a non-competitive environment excessive rates are ultimately placed upon the customers.

As to the proposal to hire additional part-time personnel the Commission finds insufficient support for this adjustment. The necessity of additional personnel is speculative and test period wage expense already includes amounts for part-time employees. Therefore, no adjustment has been allowed for this item.

Mr. Nicholas testified on April 21, 1983, that the Consumer Price Index ("CPI") was used in part to compute the wage increase in December of 1982.^{2/} The Commission finds the CPI to be a primary measure of inflation and since September, 1982, its annual Percentage increase has been 5 percent or less, declining to less than 4 percent annually through the end of April, 1983. The CPI is frequently considered by industry in wage increases, and the Commission finds it to be useful in analyzing proposed wage and salary adjustments. At the time the wage increase of December 1, 1982, was put into effect the most current index available to compute a wage increase was October, which reflected a 5 percent annual inflation rate. The Commission is of the opinion that this is the maximum that should be passed on to Okolona's customers.

Therefore, test period wage expense for permanent full-time employees has been increased by \$5,306.

Commissioner Fees

As provided in KRS 76.315 Okolona has three commissioners who are appointed by the County Judge/Executive. During the test period a total of \$14,157 was paid to the commissioners in the form of monthly fees. Each commissioner receives a monthly fee of \$399 as compensation for serving on the commission. In addition, the various fringe benefits offered to other Okolona employees as discussed in a preceding section of this Order are also available to the commissioners at no cost to them. These benefits add substantially to the monthly compensation of the commissioners of Okolona.

The Commission requested in its Order issued on February 2, 1983, a complete description of the duties and responsibilities of each commissioner. The response to this request consisted of a listing of selected sections from KRS Chapter 76 which deal with the legal requirements of commissioners for sewer construction districts and the responses gave no more specific details of the actual work performed by the commissioners. The Commission is of the opinion that Okolona has not presented sufficient evidence to justify the amount of compensation paid to its commissioners. The Commission has reviewed the fees paid by utilities of similar size to Okolona within its jurisdiction and has found that Okolona pays the highest fees of those utilities which were reviewed.^{3/} Since Okolona is a non-profit entity and the commissioners set their own fees, the Commission must carefully consider these fees. The

Commission finds no evidence in this case which would require Okolona's commissioners to receive fees in excess of those received by commissioners of other similarly sized utilities. Therefore, the Commission has made an adjustment to reduce commissioner fees to \$10,800 which represents \$300 per month per commissioner. This level of fees is comparable with commissioner fees paid by other utilities of similar size and organization as Okolona.

Payroll Taxes

Okolona proposed an adjustment to increase payroll taxes by \$1,354 based on the increase in salaries and wages proposed in the application. The Commission has made an adjustment to increase test period payroll taxes by \$172 based on the level of salaries and wages allowed herein.

Retirement Fund Contributions

Okolona proposed an adjustment of \$1,012 to increase retirement fund contributions by the employer based on the increase in salaries and wages proposed in the application. The Commission has made an adjustment to increase retirement fund contributions for the test period by \$119 based on the level of salaries and wages allowed herein.

Employee Benefits

Okolona proposed an adjustment of \$5,074 to increase test period expenses reported for employee benefits. The increase is based on an estimated 20 percent increase in health care costs, additional costs to be incurred when a new employee becomes eligible for the benefits offered, and the addition of vision care

coverage as an employee benefit. Health care coverage and dental care coverage were already offered and included in test period expenses.

The Commission finds Okolona's benefit program to be excessive in comparison to that of other utilities. Employees and commissioners are eligible for health care, dental care, and vision care coverage after a period of 6 months of full-time employment. Most, if not all water and sewer districts provide no fringe benefits to commissioners. The total costs for these benefits for employees and commissioners are borne entirely by the utility regardless of whether family coverage or individual coverage is chosen. The Commission hereby informs Okolona that the interests of the customers as well as the interests of the employees must be considered when costs are incurred by a utility. Therefore, in the future Okolona should exercise prudent management practices when evaluating employee benefit plans and instituting wage and benefit increases.

Okolona has furnished a copy of a vendor confirmation signed by its insurer in an attempt to substantiate the estimated 20 percent increase in health care costs. The Commission is of the opinion that this is insufficient evidence to support a known and measurable increase in this expense, as is explained in detail in a later section of this Order. The Commission finds no support for the estimated 20 percent increase and therefore no adjustment is allowed herein to increase annual health care insurance costs. Furthermore, the Commission finds the addition of the vision care

program as an added employee benefit to be unjustified. The Commission is not aware of any utility that provides vision care as an employee benefit. Moreover, Okolona has presented no evidence to support the overall level of benefits offered to its employees. The Commission is of the opinion that the level of benefits offered by Okolona places an undue burden on the ratepayers and therefore the increased costs for the addition of the vision care program have been disallowed herein. Rising health care costs is a matter of great concern in today's economy and the Commission must insist that utilities restrain these costs to the greatest extent possible.

An adjustment of \$2,456 has been made to increase employee benefits based on the eligibility of one new employee who was not included in the test year for benefits. This adjustment results in total annual employee benefits costs of \$11,498.

Electric and Gas Expense

Okolona proposed an adjustment to increase test period electric and gas expense by \$5,061 based on an estimated 10 percent increase in electric and gas rates. A monthly breakdown of actual test period usage for electricity and gas was furnished in Exhibit No. 9 of the application. In accordance with past practice, Okolona's test period usage has been applied to Louisville Gas and Electric Company's current rate schedules, which results in an adjustment to increase test period electric and gas expense by \$8,225.

Telephone Expense

Okolona proposed an adjustment to increase test period telephone expense by \$290 based on an estimated 10 percent increase in telephone charges. The 10 percent increase was derived through conversations with telephone company employees. The Commission is of the opinion that the basis for this adjustment is speculative and sufficient information has not been provided whereby a known and measurable adjustment could be derived. The Commission is aware that telephone charges in general have increased in Okolona's telephone service area. Furthermore, the Commission has on file in its offices the tariffs of the telephone utility which serves Okolona. However, sufficient information has not been presented concerning the telephone services and equipment used by Okolona to determine the current cost of those services. Therefore, no adjustment has been allowed to increase this expense.

Insurance Expense

Okolona proposed an adjustment to increase test period insurance expense by \$956 based on an anticipated 10 percent increase in insurance costs. A summary of bids on insurance coverage requested at the hearing on April 21, 1983, reflects total insurance costs which are less than what was actually incurred during the test period. Therefore, the Commission finds that no evidence has been presented to support an increase in this expense and no adjustment has been included herein.

Supplies

An adjustment was proposed to increase test period supplies expense by \$1,528 based on an anticipated 15 percent increase "due to inflationary pressures." The Commission is of the opinion that this proposed adjustment is speculative and no evidence has been presented to support a known and measurable change for this expense. Therefore, the proposed adjustment has not been included herein.

Repairs and Maintenance

An adjustment was proposed to increase test period repairs and maintenance expense by \$8,687 based on an estimated 15 percent increase in repair and maintenance costs and a planned expenditure to perform certain work on aeration systems nos. 1 and 2. Vendor confirmations have been filed in an attempt to substantiate the 15 percent estimate as have copies of bids from two construction companies which reflect that the planned expenditure of \$5,000 to overhaul the aeration systems may have been too low. However, Item No. 18 from the response dated April 7, 1983, reflects that Okolona does not intend to change the proposed rates to recover the additional cost associated with this possible additional expense.

The Commission finds the estimated 15 percent increase in this expense to be speculative. Vendor confirmations are not a sufficient basis for a known and measurable change in repairs and maintenance. The Commission is of the opinion that the expenditure to overhaul the aeration system is of such magnitude that this cost should be allocated over more than one accounting

period. Therefore, an adjustment has been made to increase repairs and maintenance by \$1,000 to recognize a 5-year amortization of this cost.

Okolona furnished a breakdown of repairs and maintenance for the test period which reflects expenditures for work on a roots blower compressor and for the purchase of a German Rupp Tripley High Temperature Control System. The Commission is of the opinion that the cost of these items purchased during the test year should be capitalized and depreciation recognized over their estimated useful lives. Therefore, an adjustment of \$5,430 has been made to exclude these expenditures from test period repairs and maintenance expense.

Chemicals

Okolona proposed an adjustment to increase test period chemical costs by \$7,546 based on an estimated 10 percent increase in chemical costs and an estimated increase in usage of certain chemicals. Copies of selected invoices and vendor confirmations have been filed in support of the proposed increase. The invoices reflect increases for hydrogen chloride and demurrage. No support has been provided concerning increases in other chemical costs. The Commission finds that the vendor confirmations are insufficient to support a known and measurable change. An adjustment has been made to increase test period chemical costs by \$145 to reflect the increase in the cost of hydrogen chloride and demurrage. However, the Commission finds that no evidence has been presented to support any additional adjustment.

Testing Expenses

Okolona proposed an adjustment to increase testing expenses by \$970 based on an estimated 10 percent increase in costs and an additional \$500 expenditure for a comprehensive lab analysis of the lagoons. A vendor confirmation was filed from the lab which provides routine testing services to Okolona that reflects an anticipated increase in testing costs of 8 to 13 percent. A copy of the contract concerning lab analysis of the lagoons reflects that the total cost of the comprehensive analysis will be \$5,075. However, Okolona has proposed no changes to the original adjustment of \$500.

The Commission finds that the vendor confirmations filed in support of this adjustment are not sufficient to support a known and measurable change. Therefore, no adjustment has been allowed for the estimated 10 percent increase in this cost. The Commission concurs with the need for the lab analysis. However, the evidence of record reflects that it is a non-recurring expense and the Commission has determined that the cost of this analysis should be amortized. Therefore, an adjustment has been made to increase testing costs by \$1,015 which recognizes a 5-year amortization of this cost.

Vehicle Expenses

Okolona proposed an adjustment to increase test period vehicle expenses by \$1,001 based on an estimated 10 percent increase in these costs. Vendor confirmations were filed in an attempt to support the estimated 10 percent increase. Copies of

invoices for motor oil and tires were filed as support for increases in these specific items.

The vendor confirmations which have been filed in this case do not represent sufficient support for known and measurable changes; therefore, no adjustment has been allowed for the estimated 10 percent increase. The invoices filed in support of the 10 percent increase in this expense reflect increases of 1.2 to 8.5 percent in the cost of those items listed on the invoice. However, no evidence has been presented concerning the quantity of these items which were purchased during the test period. The Commission has determined that insufficient evidence has been presented to afford a reasonable basis for an adjustment to test period vehicle expenses. Therefore, no adjustment has been allowed.

Trash Collection

An adjustment was proposed to reduce test period trash collection costs by \$346 based on an estimated 20 percent increase in collection costs and a decrease due to elimination of rental costs on a trash lugger. No evidence has been presented to support the estimated 20 percent increase in collection costs. The Commission has, however, allowed the portion of the adjustment concerning the decrease in rental costs, which results in a decrease in trash collection expense of \$795.

Expenses for Meetings, Seminars, and Educational Activities

Okolona proposed an adjustment to increase operating expenses by \$548 based on an estimated 10 percent increase in costs of attending meetings, seminars, and educational activities.

No evidence has been presented in support of the estimated 10 percent increase. The Commission is of the opinion that this adjustment is speculative. Therefore, no adjustment has been allowed.

Office Expenses

An adjustment of \$164 was proposed to increase the test period amount reported for office expenses. The adjustment was based on an estimated 20 percent increase in costs. A schedule of actual office expenses from October 1982 to February 1983 reflected \$25 more than the pro forma amount requested.

The Commission is of the opinion that insufficient evidence has been presented to support the estimated 20 percent increase and no evidence has been presented to form a reasonable basis to derive a known and measurable change. Furthermore, the schedule of actual expenses filed by Okolona includes an amount totalling \$634 for printing of "new rules and regulations" which in the opinion of the Commission is an extraordinary cost. Therefore, the Commission has allowed no adjustment to office expenses.

Professional Fees

Okolona proposed an adjustment to decrease test period professional fees by \$3,887 based on an estimated 10 percent increase in accounting fees and a decrease in certain non-recurring engineering fees. A letter from Okolona's accounting firm stated that auditing and accounting fees were anticipated to increase by approximately 10 percent.

The Commission is of the opinion that the amount of professional fees incurred by Okolona during the test period is

substantial as compared to other utilities of similar size. Okolona has had the same attorney and engineering firm since its inception 20 years ago, and the same accounting firm for 10 years. Furthermore, no indication has been given that services and fees from these firms are periodically reviewed and evaluated. The Commission hereby advises Okolona that a proper review and evaluation should be conducted periodically in accordance with sound management practices.

The Commission is of the opinion that the letter from the accounting firm regarding the anticipated increase does not provide a reasonable basis to derive a known and measurable change for this expense. Therefore, an adjustment has been made to reduce test period professional fees by \$4,900 to reflect the elimination of non-recurring engineering fees as proposed in the application.

Taxes

Okolona proposed an adjustment to increase tax expense by \$505. Certain sales and usage taxes collected and remitted by Okolona are based on gross sewer charges. Therefore, this adjustment is based on the percentage increase in rates as proposed by Okolona. An adjustment has been made by the Commission to increase taxes by \$186 based on the sewer rates allowed herein.

Depreciation

Okolona proposed an adjustment to increase test period depreciation expense by \$44,928 based on applicable depreciation on proposed future capital expenditures to be incurred over the

next 6 years. Filings subsequent to the application reflect that the depreciation proposed for certain sewer improvements was computed incorrectly due to inadvertently using shorter service lives than would normally be used for such improvements. Okolona decreased its proposed adjustment for depreciation by \$6,347 in recognition of the change in the estimated useful lives for the proposed sewer improvements.

The proposed rates for residential customers were decreased by Okolona to reflect the change in this proposed adjustment. The application includes a report from an engineering firm concerning the proposed sewer, roofing, and lift station improvements. The other proposed expenditures concerning maintenance equipment, vehicles, and office equipment are recommended exclusively by the management of Okolona. The total cost of these proposed expenditures has been presented as \$319,941.

The Commission is of the opinion that to allow this adjustment would be equivalent to providing a source of funds for future capital expenditures. The Commission recognizes depreciation as an allocation of cost for existing assets and not as a source of funds or financing. To allow depreciation on proposed future expenditures would place the current ratepayers in the position of paying for facilities to provide service to future ratepayers. The ratepayers would not have the advantages of mortgage agreements or other financial devices to insure prudent use of the funds advanced and security of the capital items acquired by such funds. Okolona has financed capital acquisitions and improvements in the past through debt instruments, grants, and

internally generated funds. There are presently no grants or excess funds available to Okolona for the proposed acquisitions. The only alternative available to Okolona would be the issuance of debt. At this time no application has been submitted by Okolona for authority to issue additional debt. Therefore, the Commission has allowed no adjustment to depreciation based on future capital expenditures.

Depreciation expense for the test period includes \$58,393 for depreciation on properties financed with assessment bond issues. The customers associated with the assessment properties are assessed a sufficient amount annually to cover principal, interest, and administrative costs for the repayment of these assessment bonds. In addition, these customers pay the regular monthly sewer rate charged to all of the Okolona customers. The proceeds from the assessment bonds were used in total to finance sewer facilities indentified in the Assessment Bond Ordinance as assessment properties. The Commission is of the opinion that allowing depreciation on the assessment properties in deriving rates in addition to the annual assessment of certain customers results in double recovery on the assessment properties. Therefore, the Commission has made an adjustment of \$58,393 to exclude depreciation on assessment properties.

The depreciation expense for the test period was based on the total utility plant in service of \$8,587,556. It is the policy of the Commission to compute depreciation expense for rate-making purposes on the basis of the original cost of the plant in service less contributions in aid of construction. The

Commission has determined that contributions in aid of construction represent approximately 26 percent of the total cost of utility plant in service.^{4/} Therefore, depreciation expense has been reduced by \$41,855 to exclude depreciation on assets purchased with contributions in aid of construction.^{5/}

In a preceding section of this Order certain expenditures were disallowed as repair and maintenance items. It is the Commission's opinion that these costs should be capitalized and depreciation should be recognized over the estimated useful lives. Therefore, an adjustment of \$1,086 has been made to increase test period depreciation expense to reflect depreciation on these items based on a 5-year estimated life.

After consideration of the depreciation issues discussed in this section total allowable depreciation expense for rate-making purposes is \$119,124.

Rate Case Expenses

Okolona proposed an adjustment to increase operating expenses by \$11,667 based on a 3-year amortization of expenses expected to be incurred for this case which include fees for accounting, legal, engineering and consulting services and costs for printing, copying and postage. The record reflects that total actual expenses through April 21, 1983, were \$36,618.

The Commission is of the opinion that the amount of expenses incurred by Okolona for this case is substantial in comparison to expenses in other cases of a similar nature reviewed by the Commission. The Commission finds no evidence in this case to indicate that Okolona exercised reasonable care in procuring

services for this case. This is evident by the failure to seek bids or make inquiries of other accounting or legal consultants for the professional services required to request an increase in rates before this Commission. The Commission is of the opinion that a careful and thorough evaluation should be conducted when expenses of such magnitude as presented in this case are incurred. The Commission informs Okolona that in the future it will be expected to exercise reasonable care when incurring expenses of substantial amounts.

The engineering fees presented as rate case expense were incurred as a result of a study made by an engineering firm and recommendations concerning specific improvements to Okolona's sewer system and related structures. The Commission is of the opinion that the expenses for this study should not be included in this case. The study includes cost estimates as well as specific instructions concerning recommendations for improvements. The expenses listed for engineering should properly be included along with other costs of the recommended projects and capitalized. Therefore, an adjustment has been made to delete engineering costs of \$5,422 from rate case expense.

Rate case expenses also included an amount for services and testimony by Mr. Andrew J. Winfrey, President of an engineering management firm in Louisville, Kentucky. Mr. Winfrey was hired to render an opinion concerning the proposals which had been made by Okolona in this case. The Commission finds no evidence to support the necessity of services provided by Mr. Winfrey in this case. The Commission has determined that the procurement of

Mr. Winfrey's services only adds to what is already a substantial amount of expenses in this case. Therefore, an adjustment of \$757 has been made to delete Mr. Winfrey's fees.

The breakdown of legal costs in this case reflects that a charge was made for two attorneys to represent Okolona at the hearing on April 21, 1983. Okolona was billed at \$90 per hour for one attorney's services and \$60 per hour for the other. Mr. Henry Huff previously indicated that his fee for this case would be billed at \$60 per hour. The Commission is of the opinion that the charges of \$90 per hour and the charges to have two attorneys present at the hearing are not justified. Therefore, an adjustment has been made to decrease legal expenses by \$585 to reflect the services of Mr. Huff only at \$60 per hour.

After consideration of the aforementioned adjustments the Commission finds total allowable rate case expenses to be \$29,854. The Commission is of the opinion that a 3-year amortization of these expenses would place an undue burden on ratepayers in light of the substantial amount involved and the lack of reasonable care exercised when incurring these expenses. Therefore, the Commission finds that an amortization period of 7 years is the fair, just, and reasonable period to use in allocating these expenses. This results in an increase of \$4,265 to test period expenses.

Margin

Okolona proposed an adjustment to increase test period expenses by \$17,773 to compensate for any increase in expenses

which had not been proposed. The amount was computed as 2.32 percent of pre-margin expenses.

The Commission is of the opinion that this proposed adjustment is speculative and provides no reasonable basis that could be used in deriving a known and measurable change. Furthermore, no evidence has been presented by Okolona to substantiate the necessity of this adjustment. Therefore, no adjustment has been allowed for the requested margin.

After consideration of the aforementioned adjustments the Commission finds that Okolona's test period operations are as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenue	\$ 479,004	\$ (18,825)	\$460,179
Operating Expenses	<u>568,799</u>	<u>(94,350)</u>	<u>474,449</u>
Operating Income	\$ (89,795)	\$ 75,525	\$(14,270)
Interest on Long-Term Debt	94,640	(4,041)	90,599
Amortization of Bond Costs	3,097	-0-	3,097
Interest Income	70,032	(30,132)	39,900
Other Income	<u>250</u>	<u>(214)</u>	<u>36</u>
Net Income	<u>\$(117,250)</u>	<u>\$ 49,220</u>	<u>\$(68,030)</u>

REVENUE REQUIREMENTS

In determining its revenue requirements in this case, Okolona requested revenues sufficient to cover all pro forma expenses and achieve a pro forma net income of zero. Okolona's revenue bond ordinances require a 1.5X debt service coverage ratio for 12 out of the preceding 18 months in order to issue additional financing. The determination of this ratio includes all normal

operating expenses as defined in the revenue bond ordinances with the exclusion of depreciation expense.

Okolona's debt service for revenue bonds based on the average principal and interest payments due within the next 5 years is \$159,310. The adjusted test period operating statement reflects a net loss of \$71,525 which provides inadequate coverage on Okolona's debt service obligations. The Commission is of the opinion that the adjusted operating income is inadequate and will adversely affect the financial condition of Okolona. To improve Okolona's financial condition and provide a 1.5X debt service coverage, additional revenues of \$94,175 are required. Based on adjusted test period results, total operating revenues of \$554,354 will produce operating income of \$79,905, which, after considering interest income of \$39,900, other income of \$36, and the exclusion of depreciation expense of \$119,124 as required by the revenue bond ordinances, will be sufficient to allow Okolona to pay its operating expenses, meet its annual debt service obligations, and provide a reasonable surplus.

RATE DESIGN

Okolona did not propose a change in rate design and the Commission will not initiate a change in rate design in this case. The additional revenue authorized Okolona has been distributed equally to each rate schedule.

The major rate design issue raised by the intervenors PMC and Woodcrest concerned Okolona's historical billing practice of allowing a 7 percent discount in instances where two or more apartments were served from the same water meter. Okolona

Proposed to eliminate this billing practice and the intervenors opposed its elimination. The Commission will permit Okolona to eliminate the discount and state to the intervenors its opinion that discounts on the consumption of utility service should not be allowed.

PMC and Woodcrest also objected to apparent inequities in Okolona's rate design. For example, in the area of primary objection, the intervenors argued that since multi-family residential customers use only 18.84 percent of the water consumed in Okolona's service area they should not be responsible for 20.7 percent of Okolona's revenue. The Commission is of the opinion that the difference of 1.86 percent is insufficient to cause a change in rate design and, furthermore, that such an analysis is not a reasonable substitute for a cost of service study as a basis for a change in rate design.

Lastly, PMC and Woodcrest suggested the use of residential equivalents in designing multi-family residential rates. The use of residential equivalents would result in a 3-bedroom apartment equalling 100 percent of the single-family residential rate, a 2-bedroom apartment equaling 75 percent of the single-family residential rate, and a 1-bedroom apartment equaling 50 percent of the single-family residential rate. The Commission will not Order Okolona to adopt residential equivalents as a basis for rate design without a specific showing that the residential equivalent approach is appropriate to Okolona's consumption characteristics.

OTHER ISSUES

Vendor Confirmations

Okolona has used vendor confirmations on several occasions in this case to support estimated increases in certain expenses. The confirmations were issued by the management of Okolona. Vendors were asked to acknowledge the price increase noted on the confirmation if they were in agreement with it and return the confirmation to Okolona.

The Commission finds that the use of these confirmations to support estimated increases are an irresponsible action on the part of management. It is not in the best interest of the utility or its customers for vendors to be notified that an increase of some magnitude is expected. In managing the affairs of the utility it is incumbent upon management to engage only in those activities which will minimize costs and thus minimize rates to its consumers. The use of vendor confirmations of price increases is clearly contrary to any such cost minimizing goals. Furthermore, the Commission is of the opinion that the percentages supplied in the confirmations are speculative, do not provide sufficient evidence to form a basis for known and measurable changes and are of no value to rate-making proceedings. Therefore, the Commission urges Okolona to discontinue the use of these confirmations.

Proposed Revenues

Okolona had originally proposed to increase its revenues by \$288,261 annually, an increase of 71 percent. However, in response to the Commission's Order dated February 2, 1983, Okolona

stated that the estimated useful life for certain proposed sewer improvements had been inadvertently determined too low. Okolona amended the amount of pro forma depreciation proposed in the application. This resulted in a reduction in proposed residential rates by 7 cents per bill. Therefore, the proposed increase in revenues was adjusted to \$281,914 annually, an increase of 69 percent.

Accounting Records

Okolona presently provides various services to other sewer utilities through contractual arrangements. Okolona does not account for these services in a manner whereby expenses associated with these services can be readily identified. In the interest of establishing rates for the customers of Okolona and of making a reasonable determination as to whether Okolona is recovering its costs in providing contractual services the Commission is of the opinion that a more precise accounting treatment should be utilized. Therefore, the Commission has determined that Okolona should begin recording revenues from contractual services in Account 914, Revenues from Merchandising, Jobbing and Contract Work, and the applicable expenses in Account 915, Costs and Expenses of Merchandising, Jobbing, and Contract Work. All subsequent filings with this Commission should reflect the use of these accounts in reporting activities concerning contractual services.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for Okolona in that they will produce annual revenues of \$554,354 and should be approved. This revenue, along with interest income of \$39,900 and other income of \$36, will be sufficient to meet Okolona's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.

2. The rates proposed by Okolona would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

3. Okolona should change its method of accounting for contractual services rendered as described herein and appropriate change should be made to the books of account to be in accordance with the Uniform System of Accounts for Sewer Utilities as adopted by this Commission.

4. Okolona has charged Brown Noltemeyer Company a fee of \$10,904 and St. Athanasius Catholic Church a fee of \$4,820 for which no evidence of cost justification has been provided and the Commission has determined that these fees should be refunded.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Okolona on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Okolona be and they hereby are denied.

IT IS FURTHER ORDERED that Okolona shall revise its accounting records concerning contractual services rendered to be

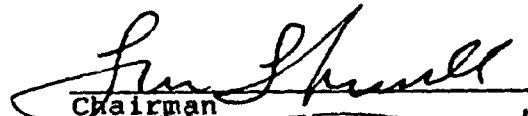
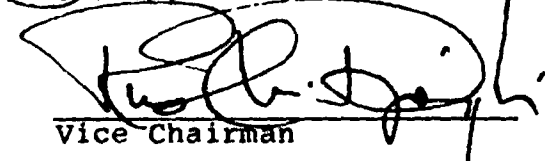

in accordance with the Uniform System of Accounts for Sewer Utilities as described herein.

IT IS FURTHER ORDERED that Okolona shall refund to Brown Noltemeyer Company the sum of \$10,904 and St. Athanasius Catholic Church the sum of \$4,820 for fees paid to Okolona which have not been cost justified. Okolona shall file evidence with the Commission that refunds have been made and properly executed to these parties within 30 days from the date of this Order.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Okolona shall file with the Commission its revised tariff setting out the rates approved herein.

Done at Frankfort, Kentucky, this 27th day of October, 1983.

PUBLIC SERVICE COMMISSION


Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

FOOTNOTES

1. Transcript of Evidence, April 21, 1983, page 42.
2. Ibid., page 159.
3. See attached Appendix B.
4. Utility plant in service for purposes of this adjustment represents the revenue bond properties and the capitalization of certain repairs and maintenance which were disallowed as such in a preceding section of this Order, less plant in process of reclassification.

5. Depreciation Expense - Test Period Actual	\$218,286
Less:	
Depreciation on Assessment Property	58,393
Add:	
Depreciation on Items Disallowed as Repairs and Maintenance	<u>1,086</u>
Depreciation Expense - Adjusted	<u><u>\$160,979</u></u>

$$160,979 \times .26 = \$41,855$$

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8751 DATED OCTOBER 27, 1983

The following rates are authorized for customers in the area served by Okolona Sewer Construction District. All other rates not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

<u>Residence</u>		<u>Monthly Rate</u>
Single-family residential		\$ 5.63
Single-family residential (Woodhill)		5.94
Multi-family residential		5.63
<u>Schools</u>		0.11984 per biling unit
<u>Commercial</u>		
Commercial	- 1	\$10.00
"	- 2	13.13
"	- 3	16.26
"	- 4	19.38
"	- 5	22.51
"	- 6	26.26
"	- 7	29.39
"	- 8	32.51
"	- 9	35.64
"	- 10	38.77
"	- 11	41.89
"	- 12	43.14
"	- 12+	43.14 plus \$0.56 per 1,000 gallons

APPENDIX B

Page 1 of 6

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8751 DATED

ANNUAL FEES

Water Districts							
<u>UTILITY</u>	<u>NUMBER OF COMMISSIONERS</u>	<u>CHAIRMAN</u>	<u>VICE CHAIRMAN</u>	<u>SECRETARY</u>	<u>TREASURER</u>	<u>OTHER COMMISSIONERS</u>	
● Barkley Lake	3	information not available					
2. Beaver Elkhorn	4	\$5,880				1) \$1,080 1) 630 1) 450	
3. Boone County	3	1,725				2) 1,725	
4. Bullock Pen	5	385		\$ 420*		1) 420 1) 350 1) 280	
5. Campbell County Ky.	3	3,600	\$3,600	3,000			
6. East Laurel	3	550		550	\$ 550		
7. Edmonson County	3	1,200		1,200*		1) 1,200	
8. Estill County	3	1,800		1,800	1,800		
9. Farndale	3	2,400		2,400	4,800		
10. Green River Valley	5	1,200		1,200		2) 1,200 1) 800	

*Secretary and Treasurer positions combined

WATER DISTRICTS

ANNUAL FEES

WATER DISTRICTS	NUMBER OF COMMISSIONERS	ANNUAL FEES				OTHER COMMISSIONERS
		CHAIRMAN	VICE CHAIRMAN	SECRETARY	TREASURER	
UTILITY						
Green - Taylor	8	480		360*		1) 480 4) 240 1) 80
12. Hardin County #1	3	3,600		3,600	3,600	3) \$3,600
13. Hardin County #2	3					
14. Hendron	3	\$2,400		\$2,400	\$2,400	1) 720 1) 660
15. Henderson County	5	720		720	720	9) -0-
16. Henry County #2	9					3) 3,600
17. Kenton County #1	3					
18. Kingston Terrell	3					
19. Laurel County #2	3	1,200		1,200	1,200	1) 175 1) 100 2) -0-
20. Lone Oak	3	1,200		1,200	1,200	3) -0-
Marion County	6	175		175		
22. Martin County #1	3					

*Secretary and Treasurer positions combined

WATER DISTRICTS

ANNUAL FEES

	<u>UTILITY</u>	<u>NUMBER OF COMMISSIONERS</u>	<u>ANNUAL FEES</u>				<u>OTHER COMMISSIONERS</u>
			<u>CHAIRMAN</u>	<u>VICE CHAIRMAN</u>	<u>SECRETARY</u>	<u>TREASURER</u>	
	McCreary County	4	3,040		395	3,040	2,695
24.	Muhlenberg County	3					3) 3,600
25.	Muhlenberg County #3	3					3) 3,600
26.	North Marshall	3	2,820				2) 2,400
27.	North Nelson	3					3) \$450
28.	Ohio County	5	\$600		\$250	\$700	2) 225
29.	Oldham County	6					6) 3,600
30.	Reidland Water-Sewer District	5					5) 1,200
31.	Sandy Valley	5					2) 600 3) 240
32.	Simpson County	3	240		240	240	
33.	South Hopkins	5	3,600		1,800*		3) 1,800
34.	Southeast Daviess County	3					3) 900
	Southern Madison County	3					3) 1,800

*Secretary and Treasurer positions combined

WATER DISTRICTS

ANNUAL FEES

UTILITY	NUMBER OF COMMISSIONERS	ANNUAL FEES					OTHER COMMISSIONERS
		CHAIRMAN	VICE CHAIRMAN	SECRETARY	TREASURER		
Spears	5						
37. Union County	4						5) -0-
38. Waco	3			1,800			4) 1,800
39. Warren County	3	2,000		2,000		2,000	
40. West Daviess	3	Information not available					
41. Wood Creek	3	900		900		900	
		1,200		1,200		1,200	

*Secretary and Treasurer positions combined

Water Associations

UTILITY

NUMBER OF COMMISSIONERS

ANNUAL FEES

Page 5 of 6

- Butler County
2. East Daviess County
3. Garrard County

5
5
7

4. Harrison County
5. Jackson County
6. Jonathan Creek
7. North Shelby Water Co.

7
8
5
7

8. Rowan Water, Inc.
9. West Laurel

5
3

CHAIRMAN	VICE CHAIRMAN	SECRETARY	TREASURER	OTHER COMMISSIONERS
information not available				

information not available

\$1,350

\$ 800*

5)	315
1)	750
1)	700
2)	650
1)	600
5)	-0-
2)	1,200

*Secretary and Treasurer positions combined

Sewer Districts

ANNUAL FEES

UTILITY	NUMBER OF COMMISSIONERS	ANNUAL FEES				OTHER COMMISSIONERS
		CHAIRMAN	VICE CHAIRMAN	SECRETARY	TREASURER	
Alexandria Construction Subdistrict #1 of Campbell and Kenton Counties	3					3) \$ -0-
2. McCracken County Sanitation District #2	3					3) 1,800
3. Okolona Sewer District	3					3) 4,971
4. Reidland Water and Sewer District	5					5) 1,200
5. Sanitation District #1 of Boyd and Greenup Counties	3	\$3,000				2) 1,500
6. Sanitation District #1 of Campbell and Kenton Counties	3	3,000	\$2,400	\$3,600*		

*Secretary and Treasurer positions combined